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Whither Stakeholder Theory? A Guide for the Perplexed Revisited

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Abstract The nature of stakeholder theory and its fundamental normative prescriptions are the subject of much confusion and academic debate. This article attempts to provide an account of both the fundamental normative implications of stakeholder theory and the theory's range of application that both stakeholder advocates and critics can agree upon. Using exclusively the language of leading stakeholder theorists, the article identifies the essential prescriptions of the theory and the type of organizations to which stakeholder theory applies in the hope of facilitating effective discussion and evaluation of the normative dimension of stakeholder theory.

Keywords Stakeholder theory · Agency theory · Organizational ethics · Labor unions

Introduction

In my MBA business ethics course, students are required to make a group presentation on an ethical issue of their choice. Last year, one group elected to explore the ethical obligations of labor unions engaged in negotiations with corporate employers. The group unquestioningly applied stakeholder theory to the union to determine how its representatives should behave. It made for quite an interesting presentation and a lively and useful class discussion. Following the presentation, however, I found myself wondering whether the group's assumption that stakeholder theory applied to labor unions was correct.

Not being a stakeholder theorist myself, I found I was unsure of both the range of the theory's application and the precise nature of its basic normative prescriptions. Accordingly, I decided to review the academic literature on stakeholder theory to improve my understanding. I somewhat naively assumed that it would be relatively easy to resolve my uncertainty by reading the leading articles on the subject. It was not.

Instead, a review of the academic literature indicated that there is presently a great deal of confusion about the nature of stakeholder theory, not the least of which concerns whether it is even proper to regard it as a normative theory.[1] Leading stakeholder theorists Robert A. Phillips, R. Edward Freeman, and Andrew C. Wicks contend that both critics and friends of stakeholder theory are mischaracterizing it, going so far as to provide a chart of eight "critical distortions" and "friendly misinterpretations (Phillips et al. 2003, p. 482)." Further, Robbin Derry has argued that a major line of research on stakeholder theory is based on incorrectly reading a principle that stakeholder theorists reject, the Principle of Who and What Really

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[1] See Part II below. See also (Freeman 1994, p. 418) ("[O]n pragmatist's [sic] grounds the stakeholder idea is part of a narrative about how we do and could live,…. Seeing the stakeholder idea as replacing some shopworn metaphors of business with new ones… is to give up the role of finding some moral bedrock for business."); and (Freeman 1999, p. 235) ("Suppose we had 100 theories…. These theories, which I prefer to call narratives, would be accounts of the role of such concepts as trust, enactment, sustainability, hierarchy, and so on, and their instrumental relationship to organizational and stakeholder performance. There is no reason to suppose that these narratives would converge or that it would be good if they did.").

Counts, as an integral feature of the theory (Derry 2012).[2] She claims that the confusion over the essence of stakeholder theory is so great that this erroneous characterization has even made it into the Wikipedia entry on stakeholder theory.[3]

Stakeholder theory is one of the dominant approaches for analyzing the normative obligations of those engaged in business. My realization that I did not have a clear grasp of its essentials took me back to the days when I began teaching business ethics and needed a primer on the basic normative theories of business ethics. At the time, I attempted to provide such a primer in an article entitled, *The Normative Theories of Business Ethics: A Guide for the Perplexed* (Hasnas 1998). It now appears that, at least with regard to stakeholder theory, that primer needs to be updated. Hence, the present article.

The purpose of this article is clarification, not argumentation. Over the past quarter century, myriad academic articles have been written advocating or criticizing stakeholder theory. The present work is most assuredly not another such article. It contains no argument either for or against stakeholder theory. Rather, this article is intended to serve a more modest, educational goal. Its purpose is to provide an account of both the fundamental normative implications of stakeholder theory and the theory's range of application that both stakeholder advocates and critics can agree upon. This is offered in the hope of ending the perennial charges that the theory is being misrepresented and subjected to straw man and evil genie arguments (Phillips et al. 2003, pp. 482–83) and facilitating a useful exchange between stakeholder theorists and their critics over the theory's merits. To realize this end, I propose to derive my account of stakeholder theory exclusively from the language of leading stakeholder theorists.

Is There Such a Thing as Normative Stakeholder Theory?

When embarking on my quest for improved understanding of stakeholder theory, I first turned to the most readily accessible description of the theory, R. Edward Freeman's article *A Stakeholder Theory of the Modern Corporation* (Freeman 2002). Over the course of the past two decades, this article has appeared in several editions of two of the most widely used business ethics texts, *Ethical Theory and Business* and *Ethical Issues in Business*.[4] There I encountered the following statement.

> "[t]he stakeholder theory" can be unpacked into a number of stakeholder theories each of which has a "normative core," inextricably linked to the way that corporations should be governed and the way that managers should act. So, attempts to more fully define, or more carefully define, a stakeholder theory are misguided (Freeman 2002, p. 44).

Being informed by the scholar most closely associated with stakeholder theory that my search for a clear definition of it is misguided was far from an auspicious beginning to my undertaking.

In their most recent work on stakeholder theory, R. Edward Freeman, Jeffery S. Harrison, Andrew C. Wicks, Bidhas L. Parmar, and Simone de Colle provide context for this statement by explaining that they are philosophical pragmatists, and as such, are offering stakeholder theory for its usefulness in improving the human condition (Freeman et al. 2010, p. 73). Accordingly, they do not view stakeholder theory as univocal in nature. They explain that

> [t]here has been a great deal of discussion about what kind of entity "stakeholder theory" really is. Some have argued that it is not a "theory," because theories are connected sets of testable propositions. Others have suggested that there is just too much ambiguity in the definition of the central term for it ever to be admitted to the status of theory. Still others have suggested that it is an alternative "theory of the

[2] Professor Derry traces how the Principle of Who and What Really Counts that Ed Freeman offered as an aspect of the separation thesis that should be rejected was misinterpreted as central to stakeholder theory to the point that

> [t]he conviction that the Principle of Who and What Really Counts is what stakeholder theory is really all about, has indeed become all pervasive. Evidenced by the Wikipedia definition, the so-called principle has become a ready synonym for stakeholder theory…. this synonymous usage of stakeholder theory and "really counting" is based on misquotes and fundamental misunderstandings.

[3] The Wikipedia entry for stakeholder theory currently identifies it with the Principle of Who and What Really Counts. See http://en.wikipedia.org/wiki/Stakeholder_theory ("The stakeholder theory is a theory of organizational management and business ethics that addresses morals and values in managing an organization. It… identifies and models the groups which are stakeholders of a corporation, and both describes and recommends methods by which management can give due regard to the interests of those groups. In short, *it attempts to address the "Principle of Who or What Really Counts."*(Emphais added)).

[4] The article appeared in the fifth, sixth, and seventh editions of Beauchamp & Bowie's *Ethical Theory and Business* and in the sixth, seventh, and eighth editions of Donaldson & Werhane's *Ethical Issues in Business*. An earlier version of the article authored jointly by Freeman and William M. Evan entitled *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism* appeared in preceding editions of Beauchamp & Bowie dating back to 1988.

> firm," contra the shareholder theory of the firm. As philosophical pragmatists we do not have much to say about these debates. We see "stakeholder theory" as a "framework," a set of ideas from which a number of theories can be derived (Freeman et al. 2010, p. 63).

Hence, Freeman and his collaborators regard it as "a mistake to see stakeholder theory as a specific theory with a single purpose. Researchers would do well to see stakeholder theory as a set of shared ideas that can serve a range of purposes within different disciplines and address different questions (Freeman et al. 2010, p. 63)."

In their oft-cited article, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications* (Donaldson & Preston 1995), Thomas Donaldson and Lee E. Preston identified three types of stakeholder theory: descriptive/empirical, instrumental, and normative. Descriptive/empirical stakeholder theory is "used to describe, and sometimes to explain, specific corporate characteristics and behaviors (Donaldson & Preston 1995, p. 70)." Instrumental stakeholder theory "is used to identify the connections, or lack of connections, between stakeholder management and the achievement of traditional corporate objectives (e.g., profitability, growth) (Donaldson & Preston 1995, p. 71)." And normative stakeholder theory "is used to interpret the function of the corporation, including the identification of moral or philosophical guidelines for the operation and management of corporations (Donaldson & Preston 1995, p. 70)." Freeman, however, "explicitly and vehemently rejects the idea that we can distinguish sharply between [sic] the three branches of stakeholder theory," arguing that

> all these forms of inquiry are forms of storytelling and that, conceptually, all three branches have elements of the others embedded within them…. The focus of theorizing needs to be about how to tell better stories that enable people to cooperate and create more value through their activities at the corporation. Creating compelling stories involves all three elements of stakeholder theory, as well as a fourth—that it is managerial. To be a good story, a given normative core has to help managers create value for stakeholders and enable them to live better lives in the real world, not in some imaginary fantasy of philosophers (Freeman et al. 2010, p. 213).

In thus offering stakeholder theory as a pragmatic approach to the management of organizations, Freeman and his colleagues seem to be contending that there is no such thing as normative stakeholder theory *simpliciter*. Although I would ordinarily regard the representations made by the originators of a theory to be authoritative, in the case of stakeholder theory, whether normative stakeholder theory actually exists seems itself to be a matter of contention. For example, Thomas Donaldson has recently argued that "[n]ormative stakeholder theory,… is *conceptually* inescapable when interpreting the modern corporation (Donaldson 2011, p. 138)."

Disagreement on this point almost certainly reflects the difference between the pragmatic and foundational approaches to ethics on the part of the contending parties; a gulf I could not possibly hope to bridge in this article. Fortunately, I do not have to. Freeman and his colleagues recognize that not all philosophers are pragmatists and that a significant portion of the academic community treats stakeholder theory not as an invitation to engage in better storytelling about value creation, but as a moral theory designed to provide ethical guidance to managers–one from which definite prescriptions as to how managers should act can be derived (Freeman et al. 2010, pp. 220-21). Although clearly not happy about this,[5] Freeman and his colleagues "nonetheless agree that a critical part of managing a business with integrity and self-reflection requires that managers face the normative questions at the heart of this line of inquiry (Freeman et al. 2010, p. 196)." Thus, whether or not there is agreement about whether something called "normative stakeholder theory" exists, there is agreement that stakeholder theory carries normative implications for managers.

This level of agreement is sufficient for the purposes of this article. If I am able to identify and clearly articulate a minimal set of the normative implications of stakeholder theory that stakeholder theorists themselves accept and subscribe to, then I will consider my mission accomplished.

What Are the Fundamental Normative Implications of Stakeholder Theory?

The recently published *Stakeholder Theory: The State of the Art* (Freeman et al. 2010) is designed to provide a comprehensive and authoritative articulation of stakeholder theory. That work identifies stakeholder theory as arising out of a combination of four ideas: the separation fallacy–the fallacious belief that business and ethics are separate realms; the open question argument–the claim that it always makes sense to ask whose interests, values, and rights are enhanced or undermined by any business decision; the integration thesis–the claim that it makes no sense to talk about either business or ethics without talking about the other as well; and the responsibility principle–the claim

[5] Freeman may reasonably feel that his creation is being abused. This appears to be an occupational hazard for pragmatists. After all, Charles Peirce, the creator of pragmatism, felt compelled to rename his theory "pragmaticism" to distinguish it from what he regarded as other philosophers' improper application of his method.

that people usually want to accept responsibility for the effects of their actions on others (Freeman et al. 2010, p. 6–8). As Freeman and his collaborators explain it, "'stakeholder theory' is simply the integration thesis plus the responsibility principle. Give up the separation fallacy, in part because of the open question argument, and there is not much alternative (Freeman et al. 2010, p. 9)." The only normative implications that derive from this are that "[p]eople engaged in value creation and trade are responsible precisely to 'those groups and individuals who can affect or be affected by their actions'–that is, stakeholders (Freeman et al. 2010, p. 9)", and hence, that businesses must "pay[] attention at least to customers, employees, suppliers, communities, and financiers (Freeman et al. 2010, p. 9)."

Unsurprisingly, given the authors' contention that there is no univocal normative stakeholder theory, the injunction that businesses "pay attention" to stakeholders does not mark out any definite normative theory. Indeed, this requirement is so broad that it is difficult to think of any normative theory of business ethics that would not qualify as stakeholder theory under it. Even Milton Friedman's "stockholder theory" that is usually offered in opposition to stakeholder theory (Freeman et al. 2010, p. xv) would be included, and Freeman and his collaborators argue explicitly that "Friedman's maximizing shareholder value view is compatible with stakeholder theory (Freeman et al. 2010, p. 12)." On this understanding of stakeholder theory, a normative theory of business ethics would have to specifically instruct managers to ignore the interests, values, and rights of one or more category of persons to fail to qualify as stakeholder theory. Since there are no such theories,[6] all normative theories of business ethics would be stakeholder theories, rendering the designation vacuous. This suggests that stakeholder theory can only be understood–as its pragmatist authors apparently intend–as an exhortation to engage in ethical reasoning about how to manage organizations.[7]

Nevertheless, at one point in their book, the authors describe a feature of stakeholder theory that has the potential to distinguish it from other normative approaches to business ethics. They state,

> [t]here are a number of competing "standard accounts" of value creation and trade. They all revolve around the idea that shareholders or owners or investors are entitled to the residual gains that accrue from value creation and trade. Stakeholder theory suggests that matters are more complicated–that is, that stakeholder relationships are involved, and that human beings are more complex than the standard accounts assume (Freeman et al. 2010, p. 10).

This is useful because it identifies a normative position—that shareholders/owners/investors are entitled to the residual gains that accrue from value creation and trade—that is not consistent with stakeholder theory.

What the authors call the "standard account" is frequently referred to as agency theory, a position whose normative implication holds that managers are ethically obligated to advance the financial interests of corporate shareholders in preference to the interests of other stakeholders–that is, that managers have an exclusive fiduciary obligation to shareholders (Maitland 1994, pp. 448–49; Heath 2009, pp. 504–06). Fiduciary obligations arise when one party to a contract has no choice but to repose trust in the other, and hence is vulnerable to the other's malfeasance or negligence. This may be the case due to disparities of knowledge or expertise (e.g., the doctor-patient relationship), the need for candor (e.g., the attorney-client and priest-penitent relationships), or the inability of the former to monitor the behavior of the latter (e.g., the trustee-beneficiary relationship). Agency theory views shareholders (and only shareholders) as standing in precisely this type of relationship to corporate managers. Why?

Agency theory conceptualizes the firm as "a nexus or network of contracts–both written and unwritten–among the firm's stakeholders" in which "[t]hese contracts, or 'internal rules of the game,' spell out the respective rights and obligations of each stakeholder (Maitland 1994, p. 449)." It also asserts that there is a principled difference between the contracts that bind most stakeholders to the firm and the contract between shareholders and the firm. Most stakeholders contract with the firm for a fixed and guaranteed return. Thus, employees sell their labor to the firm for a specified set of wages, benefits, and working conditions. Suppliers sell goods or services to the firm for agreed-upon remuneration. Customers purchase goods and services of definite description that come with express and implied warranties of merchantability and fitness. And through municipal government, even the local community can specify definite conditions under which the firm must function.

[6] Theories that require that shareholders' (or any other particular stakeholders') interests be given preference to those of other stakeholders do not instruct managers to ignore the interests of the other stakeholders. Even the most extreme versions of the shareholder theory do not instruct managers to violate the firm's contracts with employees, customers, suppliers, and local communities or to advance corporate ends by criminal activity that harms third parties.

[7] As the authors point out,

> the introduction of stakeholder theory is not one view of the firm, but an invitation to a conversation that forces managers and the public to examine together two questions that have both ethics and business thoroughly embedded in them: "what is the purpose of the corporation?" and "to whom are managers responsible?" (Freeman et al. 2010, p. 206).

In contrast,

> stockholders contract to assume a part of the risk associated with the cooperative enterprise in exchange for fiduciary claims on the corporation. The risk borne by stockholders–known as the "residual risk"–is the risk of the difference between the firm's revenues and promised payments to other stakeholders. Stockholders are not entitled to a guaranteed return; they get what is left over (if anything) after everyone else's contractually specified claims have been met (Maitland 1994, p. 449).

By agreeing to bear the residual risk, shareholders act as sureties for the other stakeholders. For example, "[e]mployees' wages are guaranteed for the duration of their contract(s) no matter if the corporation is mismanaged and runs at a loss. If the firm is managed inefficiently or corruptly, it is the stockholders who absorb any resulting loss (Maitland 1994, p. 449)." Shareholders are therefore uniquely vulnerable to managerial shirking or malfeasance, necessitating the imposition of a fiduciary obligation upon corporate management. Agency theory thus asserts precisely what the stakeholder authors deny–that "shareholders or owners or investors are entitled to the residual gains that accrue from value creation and trade (Freeman et al. 2010, p. 10)."

Having identified at least one normative theory–agency theory–that lies outside the ambit of stakeholder theory, it becomes possible to identify a normative implication of stakeholder theory. For we now have at least one substantive normative proposition that is constitutive of stakeholder theory–that managers do not have an *exclusive* fiduciary duty to shareholders/owners/investors. Under stakeholder theory, managers either do not have a fiduciary duty to shareholders/owners/investors at all, or, if they do, they have similar fiduciary duties to other stakeholders.

Admittedly, this initial analysis provides a fairly meager account of the normative implications of stakeholder theory. Fortunately, it can be supplemented with propositions previously provided in an article authored by Robert A. Phillips, R. Edward Freeman, and Andrew C. Wickes, *What Stakeholder Theory Is Not* (Phillips et al. 2003). The authors open this article with the frank recognition that coming to grips with stakeholder theory can be a challenge because it is a theory of extraordinary "conceptual breadth" such that "when used unreflectively, its managerial prescriptions and implications are nearly limitless (Phillips et al. 2003, p. 479)." Indeed, they admit that defending the theory is difficult "[o]wing in part to the ambiguity and breadth of the stakeholder theory itself (Phillips et al. 2003, p. 480)." To address this difficulty, the authors include a section of the article entitled, "What Stakeholder Theory Is," in which they attempt to provide greater clarity about the essence of stakeholder theory. There, they assert that "[s]takeholder theory is distinct because it addresses morals and values explicitly as a central feature of managing organizations," and that "[a]ttention to the interests and well-being of those who can assist or hinder the achievement of the organization's objectives is the central admonition of the theory (Phillips et al. 2003, pp. 480–81)."

This section alone does not add any specificity to our knowledge of stakeholder theory's normative implications because, like the subsequent articulation in *Stakeholder Theory: The State of the Art*, it defines stakeholder theory as all-encompassing. If the central admonition of the theory is indeed that managers pay attention to the interests and well-being of those who can assist or hinder the achievement of the organization's objectives, then all normative theories of business ethics are stakeholder theories. Were this the whole of stakeholder theory, then stakeholder theory would consist of an injunction to practice good management that was devoid of any specific ethical guidance.

More specificity is provided, somewhat ironically, in the section of the article entitled "What Stakeholder Theory Is Not." In that section, the authors identify the ways in which stakeholder theory differs from agency theory and any Friedmanesque stockholder theory both distributively–with regard to how the value created by the organization is distributed–and procedurally–with regard to who has input into managerial decisions. The authors explain that

> stakeholder theory, when applied to for-profit business organizations, is consistent with value maximization. We should distinguish, however, between value maximization and *maximizing shareholder wealth* or *stock value/share price*. Maximizing value says nothing about who gets a say in the decision-making or who gets how much of this value, so maximized. It is only when the primary beneficiary of this profitability is constantly and exclusively a single stakeholder (e.g., equity share owners) that there is conflict between the theories. An organization that is managed for stakeholders will distribute the fruits of organizational success (and failure) among all legitimate stakeholders. Moreover, managing for stakeholders will include communication between managers and stakeholders concerning *how* profits should be maximized (Phillips et al. 2003, pp. 486–87).

This makes our earlier derived principle–that managers do not have an exclusive fiduciary duty to shareholders–more definite by specifying that stakeholder theory requires managers to "distribute the fruits of organizational success (and failure) among all legitimate stakeholders (Phillips et al. 2003, pp. 486)." It also points us in the direction of a second substantive normative implication of stakeholder theory–that all relevant stakeholders must have input into the managerial decision-making process.

The authors emphasize the importance of this second principle, explaining that "[s]takeholder theory is concerned with who has input in decision-making as well as with who benefits from outcomes of such decisions. Procedure is as important to stakeholder theory as the final distribution (Phillips et al. 2003, p. 487)." Thus,

> Among the prescriptions of much of stakeholder theory is that relevant stakeholders should have input in the decision-making processes of the organization. This may be for either instrumental reasons (e.g., achieving "buy in") or for normative reasons–the organization has a moral obligation to its stakeholders requiring that they have input into how the organization is run. Thus, stakeholder theorists and critics should be fully cognizant of the procedural prescriptions of the theory as well as the distributive (Phillips et al. 2003, p. 487).

Although the authors are agnostic as to the form of stakeholder input, declaring that "[t]he method of stakeholder input is an open question," they make it clear that "however it is achieved, it is important for the sake of ethics… that stakeholders be accorded some say in determining not only how much of the organization's outputs they receive, but how those outputs are created (Phillips et al. 2003, p. 490)."

Finally, the authors provide additional definition to the normative contours of stakeholder theory by identifying the parties to whom managers owe moral obligations. They explain that

> stakeholders may be usefully separated into normative and derivative stakeholders. Normative stakeholders are those to whom the organization has a direct moral obligation to attend to their well-being. They provide the answer to the seminal stakeholder query "For whose benefit ought the firm be managed?" Typically normative stakeholders are those most frequently cited in stakeholder discussions such as financiers, employees, customers, suppliers, and local communities (Phillips et al. 2003, p. 489).

This account of the normative implications of stakeholder theory accords well with the statement of stakeholder theory that Freeman has provided for the past two decades in *A Stakeholder Theory of the Modern Corporation* (Freeman 2002).[8] This article contains what is perhaps the classic expression of stakeholder theory in Freeman's statement that

> My thesis is that I can revitalize the concept of managerial capitalism by replacing the notion that managers have a duty to stockholders with the concept that managers bear a fiduciary relationship to stakeholders. Stakeholders are those groups who have a stake in or claim on the firm. Specifically I include suppliers, customers, employees, stockholders, and the local community, as well as management in its role as agent for these groups…. [E]ach of these stakeholder groups has a right not to be treated as a means to some end, and therefore must participate in determining the future direction of the firm in which they have a stake (Freeman 2002, p. 39).

Freeman subsequently encapsulates the essence of stakeholder theory in what he calls the Stakeholder Enabling Principle, which states: "Corporations shall be managed in the interests of its [sic] stakeholders, defined as employees, financiers, customers, employees, [sic] and communities (Freeman 2002, p. 47)."[9]

At this point, I believe we have identified the fundamental normative implications of stakeholder theory. These implications may be summarized as follows. Managers of an organization do not have an exclusive fiduciary duty to any one stakeholder group, but rather, are obligated to ensure that the value created by the organization is distributed among all normative stakeholders and that all normative stakeholders have input into the managerial decisions that determine how the organization attempts to create that value. Normative stakeholders include the organization's financiers, employees, customers, suppliers, and local communities.

What Is the Range of Application of Stakeholder Theory?

Understanding the fundamental normative implications of stakeholder theory is helpful, but insufficient. Non-expert laypersons still need to know what type of entities are subject to stakeholder theory for the theory to be useful to them. What, then, is the range of application of stakeholder theory?

Stakeholder theorists make it clear that stakeholder theory is not "a comprehensive moral doctrine"–one "which can address the full array of moral questions that arise without reference to any other theory (Freeman et al.

[8] As noted previously, this article appeared in several editions of both *Ethical Theory and Business* and *Ethical Issues in Business* between 1997 and 2008, and in editions dating back to 1988 of the former in its earlier version, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*.

[9] The word "employees" erroneously appears twice in the text. Clearly the second occurrence of the word was intended to be "suppliers."

2010, p. 230)." Rather, "stakeholder theory is a theory of organizational ethics," which is distinguished from moral and political theory by its focus on voluntary associations rather than the basic structure of society (Phillips et al. 2003, p. 493).

Stakeholder theory, then, is limited to the universe of organizations, which are understood as voluntary associations. But does it apply to all voluntary associations or only to some? To which organizations does stakeholder theory apply?

The vast majority of both academic and non-academic articles on stakeholder theory address the application of the theory to for-profit corporations. Indeed, as the stakeholder theorists themselves note, stakeholder theory is typically offered as a counterweight to Milton Friedman's stockholder theory, which specifically addresses the moral responsibilities of for-profit businesses (Freeman et al. 2010, p. 10). But this does not decide the matter. The vast majority of articles on Constitutional interpretation address the Equal Protection and Due Process Clauses. This does not imply that the theories of Constitutional interpretation apply only to those clauses. The focus on for-profit corporations in the former case and the Equal Protection and Due Process Clauses in the latter is a reflection of what most authors find to be of interest, not the conceptual limits of the theories.

The actual language and logic of stakeholder theory provide no reason to believe that its range of application is limited to for-profit corporations. According to its leading advocates, stakeholder theory was developed to address (1) the problem of value creation and trade, (2) the problem of the ethics of capitalism, and (3) the problem of the managerial mindset (Freeman et al. 2010, pp. 4–5). None of these problems concern for-profit corporations exclusively. Value creation and trade are engaged in by more than merely for-profit corporations; the ethics of capitalism will apply to all market actors, not just for-profit corporations; and the managerial mindset is relevant to any organization that must be managed.

Stakeholder theorists clearly indicate that their theory is intended to apply to more than merely for-profit corporations. Statements such as "stakeholder theory, *when applied to for-profit business organizations*, is consistent with value maximization (Phillips et al. 2003, p. 486 (emphasis added))" clearly imply that stakeholder theory can be applied in other contexts as well. Further, stakeholder theorists apply stakeholder theory to the management of health care organizations, the majority of which are non-profits (Freeman et al. 2010, pp. 172–77). Indeed, stakeholder theorists explicitly state that "limiting [stakeholder theory] solely to publicly traded corporations is a mistake that misses some of the potential richness of stakeholder theory," and that the theory is "potentially relevant to 'small or family owned businesses, privately owned concerns of any size, partnerships, non-profit and governmental organizations' (Freeman et al. 2010, pp. 230–31)."

Can we be more precise about the nature of the organizations to which stakeholder theory applies? Yes, because Robert A. Phillips has provided insight on precisely this issue in his book, *Stakeholder Theory and Organizational Ethics* (Phillips 2003). In that work, Phillips makes it clear that stakeholder theory is a theory of organizational ethics, explaining that "[o]rganizations differ from individuals and from states in important ways. The ethical theory constructed to guide each should therefore differ in important ways (Phillips 2003, p. 41)."[10] Phillips then goes on to provide three essential distinguishing characteristics of organizations: freedom of exit, value of contribution, and orienting aims and purposes. Freedom of exit is interpreted expansively, including both "the possibility of exit [that] is constitutive of organizational membership" and "the possibility of ejection of one or several members by other members" of the voluntary association (Phillips 2003, pp. 46–47). Value of contribution refers to "the knowledge and control one has over one's commitment and contribution (Phillips 2003, p. 47)." Thus, "[a]t the level of private associations, it is acceptable for both individual members and organizations to have knowledge of the relative contribution of the other prior to a decision to interact (Phillips 2003, p. 48)." Finally, orienting aims and purposes refers to the fact that "[p]eople join and remain with associations, just as they are recruited and evaluated, on the basis of the association's objectives (Phillips 2003, p. 48)."

We may deduce from this that stakeholder theory applies to organizations understood as voluntary associations (1) formed to realize specified aims and purposes (2) that allow members to freely exit (and freely eject other members from) the association, and (3) that attract and retain (as well as recruit and evaluate) members on the basis of their interest in advancing the association's objectives. Both for-profit and non-profit businesses obviously satisfy these conditions. In a market environment, all businesses are voluntary associations formed to realize specified aims and purposes. The distinction between for-profit and non-profit businesses is that the generation of profits for the firm's shareholders/owners/financiers is among the aims and purposes of the former, but not the latter. Both forms of business permit members to freely exit–employees may quit, shareholders sell their stock, donors refrain from donating–and freely eject other

[10] Phillips' view is shared by the other leading stakeholder theorists as is evidenced by their ratification of it in *Stakeholder Theory: The State of the Art* (Freeman et al. 2010, p. 230).

members–employees may be fired, shareholders bought out, and donations rejected or returned. And both forms of business attract and retain (and recruit and evaluate) employees and financiers on the basis of their interest in advancing the firm's objectives, which in the case of for-profit businesses includes the generation of profits for the financiers. Stakeholder theory, then, appears to apply to all forms of business organization, whether for-profit or not.

Does stakeholder theory also apply to other organizations such as charities, cause-oriented non-governmental organizations (NGOs), and labor unions? Does the fact that these are not "business" organizations make a difference? Apparently not, since these types of organizations appear to satisfy all three conditions for the application of the stakeholder theory. They are all voluntary associations that are formed to realize specific aims and purposes, such as providing for those in need, advancing a political or moral cause, or improving the material well-being of their members. Members of charities, NGOs, and unions are free to resign from the organization and such organizations have the power to expel members. And members join and remain with charities, NGOs, and unions entirely on the basis of their interest in the organization's objectives and are recruited to advance those objectives. Such organizations appear to fit the stakeholder bill perfectly.

This should not be surprising. Although stakeholder theory is most frequently applied to publicly owned corporations, its advocates continually reiterate that it is a "managerial" theory (Freeman 1999, p. 233; Phillips et al. 2003, p. 492; Freeman et al. 2010, p. 213)–one that "is distinct because it addresses morals and values explicitly as a central feature of *managing organizations* (Phillips et al. 2003, p. 481 (emphasis added))." Charities, NGOs, and labor unions are organizations that designate a small number of executives to determine what actions the organization should take as a collective entity. These executives are charged with managing the organization's affairs to most effectively achieve its organizational objectives. Charities, NGOs, and labor unions must be managed every bit as much as any for-profit or non-profit business. To the extent that stakeholder theory is designed to provide ethical guidance to managers of organizations, there is no reason why it should not apply to charities, NGOs and labor unions as well as to for-profit and non-profit businesses. Hence, it appears that my students' assumption that stakeholder theory applies to labor unions was entirely correct.

An Illustrative Application

This analysis represents my best effort to provide an accurate account of both the fundamental normative implications of stakeholder theory and the theory's range of application. I recognize, however, that this account is a rather abstract one that could benefit from the clarity provided by a concrete example. Thus, I propose to examine how the normative implications of stakeholder theory play out when applied to labor unions–a context that seems appropriate given that it was my students' application of stakeholder theory to labor unions that stimulated me to undertake this investigation in the first place.[11]

Stakeholder theorists assert that "[t]he question of what management should do, and who should matter in their [sic] decision making, is a central question of stakeholder theory (Freeman et al. 2010, p. 209)." What, then, does stakeholder theory tell us about what those who manage labor unions should do and who should matter in their decision making?

Our analysis of the normative implications of stakeholder theory yielded the twin propositions that managers of an organization are obligated to ensure (1) that the value created by the organization is distributed among all normative stakeholders and (2) that all normative stakeholders have input into the managerial decisions that determine how the organization attempts to create that value. The first question to ask, then, would be who are a labor union's normative stakeholders.

Over the years, a rough consensus has been reached among stakeholder theorists that the normative stakeholders of for-profit businesses consist of the firm's financiers, employees, customers, suppliers, and local communities (Freeman et al. 2010, p. 207). No such consensus is available regarding the parties that constitute a labor union's normative stakeholders. Therefore, to resolve this question, we would have to return to the basic definition of a normative stakeholder–identified variously as "any group or individual who can affect or is affected by the achievement of the organization's objectives (Freeman et al. 2010, p. 209)," any "persons or group of persons [who] voluntarily accept the benefits of a mutually beneficial scheme of cooperation requiring sacrifice or contribution on the parts of the participants (Phillips 2003, p. 92)," and "those groups without whose support, the firm would fail to exist (Dunham et al. 2006, p. 25),"–and attempt to apply it to labor unions directly.

It seems clear that a labor union's membership, employees, suppliers, and corporate employers would be

[11] Please note that this illustration is offered for purposes of clarification only, not exegesis. I make no effort to provide a definitive statement of how stakeholder theory applies to labor unions. I am not a stakeholder theorist, and cannot claim the level of expertise necessary to such a task. The most I can and do claim is that my description in this section represents how the non-expert practitioner or theorist would expect stakeholder theory to apply to labor unions given the theory's essential characteristics.

stakeholders. Union members would be the analog of financiers in the traditional stakeholder model of the firm since they supply the funding that is necessary to the union's creation and continued operation, and they are completely invested in the union's objectives. Similarly, corporate employers would be the analog of the customer in the traditional model since they purchase the labor of the union's members, and both their and the union's success is crucially dependent upon the nature of the relationship between them. It also seems reasonable to regard the corporate employer's customers, suppliers, and local community as stakeholders in the union since their well-being is directly dependent on the quality of the labor union's relationship with the firm–each would be directly affected by strikes, the outcome of labor/management negotiations, etc.–and their interactions with the firm directly affects the union's ability to realize its objectives.[12]

Once the union's normative stakeholders have been identified, the substantive normative implications of stakeholder theory may be applied. The first implication instructs us that the managers of an organization do not have an exclusive fiduciary duty to any one stakeholder group, but are obligated to ensure that the value created by the organization is distributed among all the normative stakeholders of the organization. In the traditional stakeholder model of the firm, this implies that managers do not have an exclusive fiduciary duty to shareholders, but must ensure that the value created by the organization is distributed among the firm's employees, suppliers, customers, and local communities as well. In the context of labor unions, this proposition must mean that the union's managers do not have an exclusive fiduciary duty to the union's membership, but must ensure that the value created by the union is distributed among the union's employees, suppliers, corporate employers, and the corporate employers' suppliers, customers, and local community.

Similarly, the second substantive normative implication of stakeholder theory instructs that managers must ensure that all normative stakeholders have input into the managerial decisions that determine how the organization creates value. In the traditional stakeholder model of the firm, this implies that managers must either provide a direct avenue of input for or act as representatives of the firm's employees, suppliers, customers, and local communities in deciding how the firm should act. In the context of labor unions, this proposition must mean that the union's management must either listen to or consider the interests of not only the union's members, but also its employees, suppliers, corporate employers, and the corporate employers' suppliers, customers, and local community in deciding on the course of action that the union should undertake.

In practice, this means that those who manage the affairs of labor unions are ethically obligated to consider more than merely the interests of their members when negotiating wages and benefit packages, setting work rules and grievance procedures, threatening or authorizing strikes, endorsing and supporting political candidates, and attempting to influence public policy. Stakeholder theory obligates union leaders to consider the impact of all such activities on the union's employees, suppliers, corporate employers, and the corporate employers' suppliers, customers, and local communities. Any value created by these activities may not be appropriated solely by the union membership, but must be distributed among all of the union's stakeholders, and all the stakeholders must have input into the decisions on whether and how to pursue such activities.

For example, a labor union's strategy in negotiating a collective bargaining agreement must take into account the costs its terms would impose on the union's corporate employers and the employers' suppliers, customers, and local communities, and be designed to arrive at a package that increases the well-being of not merely the union's members, but of all of these stakeholder groups. Further, each of these groups would have to have input into the determination of the union's negotiating strategy, whether the input comes from having an actual representative on the union's governing board or from the requirement that members of the board seriously represent the various stakeholders' interests.

The same would be true for the union's other activities. Employers would have to have input into decisions as to whether to authorize or continue a strike, and the union's management would be required to consider the effect of the strike not only on the corporate employer's bargaining position, but also on the well-being of the employer and its suppliers, customers, and local community. Should a strike reach a point at which continuing to pursue the interests of the union membership would inflict too much damage on the interests of the larger community of stakeholders, the union's management would be ethically obligated to terminate the strike. Similarly, union employees, suppliers, corporate employers, and the corporate employers' suppliers, customers, and local communities would have to be granted input into decisions as to whether and how to attempt to influence the outcome of elections or to engage in lobbying activity, and any such activity would have to be designed to produce benefits for the entire community of stakeholders, not merely the union membership.

[12] Robert A. Phillips asserts that the corporate employer's suppliers would not be normative stakeholders of the union under the second of the three definitions of stakeholders because they have not voluntarily accepted the benefits of a mutually beneficial scheme of cooperation requiring sacrifice or contribution on their part. Although I am not entirely clear on why this is the case, I am happy to bow to his superior expertise on this point.

It may seem odd at first to assert that a labor union, which is organized and financed by its members for the purpose of improving their material well-being, should not be managed exclusively for its members' benefit–that union leaders do not have an exclusive fiduciary obligation to the union's members to promote their interests in preference to those of their employers and others. But this feeling should dissipate upon reflection. For this assertion is surely no more odd than the claim that a for-profit business or corporation, which is organized and financed by its owners or shareholders for the purpose of improving their material well-being, should not be managed exclusively for its owners' or shareholders' benefit–that corporate managers do not have an exclusive fiduciary obligation to the firm's owners or shareholders to promote their interests in preference to those of the firm's employees, suppliers, customers, and local community. Indeed, from the perspective of stakeholder theory, what would be odd would be the assertion that union leaders *did* have an exclusive fiduciary obligation to union members.

When applied to the firm, one of the purposes of stakeholder theory is to bring the interests of all of the firm's normative stakeholders into the ethically proper balance. The objection to what stakeholder theorists call the "standard account" of the firm is precisely that the existence of an exclusive fiduciary duty to owners or shareholders makes achieving such balance impossible. The same must be true in the case of labor unions. An exclusive fiduciary duty to union members would necessarily make it impossible to achieve the ethically proper balance among all of the union's normative stakeholders.

When I began the research for this article, I was uncertain as to whether my students were correct to apply stakeholder theory to labor unions. After analysis, it not only appears that they were, but that the application of stakeholder theory to labor unions is a necessary complement to the stakeholder model of the firm. That model identifies five main stakeholder groups: financiers, suppliers, customers, the local community, and employees. The financiers are represented by the firm's management, which under stakeholder theory is barred from pursuing the financiers' interests exclusively. Suppliers are usually business firms themselves, whose management is bound by stakeholder theory to consider the interests of its customers in its decision-making. Hence, suppliers will similarly be barred from dealing with the firm exclusively to serve their financial self-interest. Customers are usually an unorganized group, and hence, typically do not have the capacity to act effectively in a completely self-serving way in their dealings with the firm. The local community is usually represented by the municipal government, which (at least in theory) is ethically bound to act for the common good. Thus, under stakeholder theory, all of these stakeholder groups are either ethically barred or unable to deal with the firm in an exclusively self-interested or exploitative manner.

In these circumstances, it would be both incongruous and disruptive of the effort to bring the interests of the firm's stakeholders into an ethically proper balance for a firm's employees, when represented by a labor union, to be free to ignore the interests of the firm's other stakeholders and to deal with the firm in an exclusively self-interested manner. Hence, the inherent logic of the stakeholder model of the firm itself seems to imply that stakeholder theory must apply to labor unions as well.

Conclusion

This article is being offered to serve two purposes. The first is to update my earlier article, *The Normative Theories of Business Ethics: A Guide for the Perplexed* (Hasnas 1998). That article was designed to supply a clear statement of the leading approaches to business ethics to those who were not immersed in the academic literature. In the years since that article was published, stakeholder theory has evolved to the point such that the earlier article's characterization of it is no longer accurate. The present article is offered as a remedy for that.

The second purpose is to get a clear statement of the fundamental normative implications of stakeholder theory on the record. Over the past two decades, much of the academic debate about stakeholder theory has not been over whether the theory is cogent, but over what the theory says and how it is being mischaracterized. Using only the words of the leading stakeholder theorists and being careful not to take them out of context, I am putting forward as clear a statement as I can of what those words communicate to a general audience.

Nothing in this article addresses the role stakeholder theory plays in the fields of strategic management, finance, accounting, management, marketing, and the other related fields Freeman and his colleagues discuss in *Stakeholder Theory: The State of the Art* (Freeman et al. 2010, Part II). This article is strictly limited to the identification of the fundamental ethical obligations of managers that follow from stakeholder theory. My goal has been to provide an account of these obligations that is both regarded as accurate by stakeholder theorists and intelligible to non-stakeholder theorists. It is offered in the hope that such an account will facilitate future discussion and evaluation of the normative dimension of stakeholder theory.

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